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E.O. 12958: N/A
TAGS: ECON ELAB EFIN PINR PGOV MX
SUBJECT: CALDERON SENDS MEXICO'S 2008 BUDGET PROPOSAL TO CONGRESS

Summary

¶1. (U) President Calderon presented his 2008 federal budget proposal to the Chamber of Deputies on September 8, 2007. The $220-billion spending plan is based on assumptions of 3.5% real GDP growth, inflation of 3.0%, a Mexican oil mix price of USD 46.60 a barrel, and an average nominal exchange rate of 11.3 pesos to the dollar. The proposal does not incorporate a tax reform package currently being considered in Congress, but if the initiative passes as expected, the government can amend the budget to reflect an estimated USD 10.6 billion (1.1% of GDP) in additional revenue. The government has said it will spend the additional USD 10.6 billion on infrastructure and social projects.

Fiscal Reform Missed First Deadline

¶2. (U) President Felipe Calderon submitted his government's 2008 federal budget proposal to the Chamber of Deputies (lower house) on September 8. The budget proposal does not include additional revenue from a pending tax reform that the administration had hoped to pass before the budget draft was due to Congress. Talks over the tax initiative stalled last week because of an impasse over an electoral reform bill, which the opposition insists be approved in tandem with fiscal reform. Lawmakers have said they will resume debate on fiscal reform this week. If the initiative passes as expected, the government can amend the budget to reflect the increase in revenue.

The Budget Proposal

¶3. (U) In the spending plan, net expenditures total USD 220

billion (2.39 trillion pesos) -- up 3.3% from the approved 2007 budget but down 1.1% in real terms from an estimate of 2007 spending. Proposed programmable expenditures are USD 163 billion, up 3.4% from the 2007 budget in real terms. The budget assumes the following for 2008: real GDP growth of 3.5%, an average consumer price inflation rate of 3.0%, an average nominal exchange rate of 11.3 pesos per dollar, a current account deficit of 1.0% of GDP, and an average price of the Mexican crude oil basket of USD 46.60 per barrel ($3.80 a barrel above the 2007 approved budget). The plan is based on oil production and exports of 3.1 and 1.7 million barrels per day, respectively. Budget calculations assume that the U.S. economy grows 2.8% and that U.S. industrial production expands by 3.1% in real terms next year.

¶4. (U) The budget is balanced using the narrow definition of the budget balance, but the broader measure of the budget balance -- the Public Sector Borrowing Requirement (PSBR) -- is a deficit of 2.0% of GDP (vs. 1.7% in the 2007 budget). Interestingly, a September 8 press release from the Finance Secretariat (Hacienda) says tQat the public sector could end

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the 2008 budget year -- which coincides with the calendar year -- with a deficit because of one-time costs associated with the pension reform approved earlier this year. The size of the deficit will be a function of how many workers choose to switch to individual retirement accounts from the existing defined-benefits pension system, something that will not be known until September 2008. The Budget and Fiscal Responsibility Law requires the budget to be balanced except in extraordinary situations -- a category the government says pension reform fits.

¶5. (U) According to Hacienda, the proposal reflects the

objectives outlined in the administration's National Development Plan. Specifically, it aims to increase the impact of social spending and foster productivity and employment, improve public security, encourage infrastructure development, increase resources designated to environmental protection, and continue efforts to make government spending more "austere" and more efficient. When compared to the approved 2007 budget, spending on public security and law enforcement, social development, and economic development are up 8.1%, 2.7%, and 2.6%, respectively, in real terms. Pemex and the Federal Electricity Commission can expect a real increase in their budgets of 5.3% and 4.3%, respectively. The Public Safety Secretariat's budget will increase by 14.6%. The proposal also includes a USD 933-million cut in the federal government's operational and administrative costs. These funds will be reallocated to health, science, technology, and investment. As in the past, the government expects to reduce net external public debt by at least USD 500 million.

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Government Highlights Importance of Fiscal Reform
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¶6. (U) During a press conference over the weekend, Calderon urged lawmakers to pass the pending fiscal reform bill, commenting that the current budget is "insufficient" to meet the needs of the country. He said that additional funds would be used for infrastructure projects, higher education, health services, Pemex, and the Federal Electricity Commission.

¶7. (U) Hacienda estimates that fiscal reform would generate US$10.6 billion (1.1% of GDP) in additional revenue -- of which around 70% would go to the federal government and 30% to federal entities. According to the September 8 press release, the passage of fiscal reform would demonstrate Mexico's ability to improve its competitiveness, lead to more investment in infrastructure, lower interest rates and

country risk, stimulate private investment, and boost economic growth from 3.5% to 3.7% next year. Hacienda said that extra funds could be distributed as shown in Table ¶1.

Table 1. Distribution of Additional Federal Income From Fiscal Reform

Category	Million USD
Competitiveness and Job Creation	5,626
Infrastructure	4,943
- Communication and transport	1,512
- Water	750
- Energy	2,681
Reduction of electricity rates	683
Human Development	1,713
Hospital Infrastructure	329
Strengthening IMSS (social security)	375
Support for poorer municipalities	275
Municipal public security	329
Higher education	404

Comment

¶8. (SBU) Post's initial impression is that the budget is austere and well thought out, though it is likely to be substantially modified. The government's first draft is a negotiating ploy designed to expedite congressional approval of fiscal reform. Post maintains that this legislation will

be approved in time to be incorporated into the 2008 budget -- which we understand to be October 20, the deadline for the lower house to approve the income component of the budget. The tax package could be passed as early as this week, though problems with electoral legislation could delay it further.

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